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424541—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 692

H. S. RICHARDSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 38–63) is reported in 42 B. T. A. 830. The opinion of the Circuit Court of Appeals (R. 143–149) is reported in 121 F. (2d) 1.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 25, 1941 (R. 149). The petition for a writ of certiorari was filed on October 9, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. The taxpayer gave his wife a large amount of securities which she thereafter transferred to him in trust for the benefit of their minor children. He was given the right to terminate the trust at any time and receive the corpus outright. He also had full power to sell or exchange the trust property, to borrow from the trust, and to use the trust income and proceeds to pay for premiums for life insurance for himself and his wife. Is the trust income taxable to the taxpayer under Section 22 (a) of the Revenue Act of 1932?

2. The taxpayer borrowed stock for the purpose of making short sales. In the circumstances of this case, was the taxpayer's gain or loss realized in the year in which he returned the borrowed stock to the lenders or in the year in which he made certain purchases of the stock which were noted on the books of his account as matching certain of the short sales?

STATUTE INVOLVED

Revenue Act of 1932, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(r) *Limitation on Stock Losses.*—

* * * * *

(s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

* * * * *

STATEMENT

Petitioner seeks to have this Court review two separate and unrelated issues with respect to his income tax liability for the year 1933. The facts as found by the Board of Tax Appeals (R. 39–48, 52–57) will be summarized separately for each issue.

TRUST INCOME ISSUE

In July, 1931, the taxpayer gave his wife 57,500 shares of stock having a value of approximately $4,000,000 (R. 41). In May, 1932, the wife transferred 42,500 of these shares back to the taxpayer under five trust instruments, one for the benefit of each of their five minor children (R. 43). The trust instrument for each child provided that until the child reached 21, so much of the trust income as the trustee deemed advisable was to be spent for the child's "maintenance, education or benefit"; after the child reached 21 and until he became 35, he was to receive directly so much of the trust income as the trustee deemed advisable; and when the child reached 35, all accumulated trust income was to be paid to him and he was thereafter to receive all of the income of the trust for life. Upon the death of the child, the trust was to terminate

and the principal and any unpaid accumulation of income was to be paid over to the child's descendants, or, in certain circumstances, to his brothers and sisters. (R. 44.)

Despite the foregoing provisions for the benefit of the taxpayer's children, the taxpayer was given the absolute right to cancel and terminate the trust at any time he chose and to take the corpus of the trust himself outright (R. 45). He was also given "full power and authority, in his absolute and uncontrolled discretion", to sell or exchange the trust property at any time for such price as he deemed advisable and to reinvest the proceeds in property of any character; to spend the trust income and proceeds in "payment of premiums for life insurance" upon his own life or that of his wife; to purchase for the trust real or personal property from himself or his wife and to make secured or unsecured loans to himself or his wife without liability "in any way for any loss resulting to the trust estate by reason of such purchase or loan"; and to cause the trust securities to be registered in his name as trustee, or in his own name, or in the name of his nominee (R. 44–45).

During the taxable year 1933 taxpayer received dividends on the stock held in trust in the amount of $121,125, made payable to his order as trustee for each of his children (R. 45). The Commissioner included the amount of these dividends in the taxpayer's income on the theory that the taxpayer had not made a valid gift to his wife of the securities which formed the trust *res*, that therefore the taxpayer, rather than his wife, must be considered as the grantor of the trusts, and that, so considered, the taxpayer was taxable on the trust income because he had reserved the right to revoke (R. 47). The Commissioner also determined that the trust *res* was subject to the taxpayer's unfettered command, free from all trusts (R. 47–48).

The Board of Tax Appeals held that the taxpayer's gift to his wife was valid. It further held, however, that in view of the taxpayer's complete control over the trust corpus and his right to take the corpus outright, the transfer of the stock to

him must be considered as a gift to him from his wife rather than as a transfer in trust. Because the property and its income were subject to his unfettered command, the Board concluded that the income was taxable to him under the provisions of Section 22 (a). (R. 51–52.) The Circuit Court of Appeals, without considering the nature of the transfers from the taxpayer to his wife or from the wife to the taxpayer, affirmed the decision of the Board on the ground that unfettered control over the corpus of a trust is the equivalent of ownership of the trust property for tax purposes (R. 146).

SHORT SALE ISSUE

In February, 1932, the taxpayer decided to make short sales of Drug, Inc. stock and instructed the Piedmont Financial Company of New York (hereinafter referred to as the management company) to make such sales on his behalf as his agent. The management company thereupon opened a new custodian account for the taxpayer with the Bankers Trust Company, known as the "Piedmont Account No. 18". (R. 53.) The management company also opened on its own books an account known as "Short Account No. 18", which was maintained for the taxpayer during the period from February 25, 1932 until July 17, 1933. During that period numerous sales and purchases of Drug, Inc. stock were made for the taxpayer, each of which was recorded in Short Account No. 18. (R. 26,[1] 53.)

Instead of borrowing shares from brokers to make deliveries against his proposed short sales, the taxpayer borrowed from time to time during 1932 a total of 25,700 shares of Drug, Inc. stock from the Piedmont Financial Company of Delaware (hereinafter referred to as the holding company) and a total of 2,000 shares of Drug, Inc. stock from the Piedmont Development Corporation. These borrowed shares were placed in the

[1] The photostat copy of Short Account No. 18, consisting of eight pages, is inserted after R. 26.

taxpayer's custodian account with the Bankers Trust Company. The taxpayer also borrowed 2,000 shares of Drug, Inc. stock from Dawson-Smith on July 27, 1932, and returned them to the lender on August 22, 1932, apparently by using for that purpose the 2,000 shares borrowed from the Piedmont Development Corporation on the same date. The 2,000 shares borrowed from the Piedmont Development Corporation were not returned to it until June 29, 1933, and the shares borrowed from the holding company were not returned to it until July 21, 1933, shortly after Short Account No. 18 with the management company was closed out. (R. 53–54.)

The sales, deliveries, and purchases in Short Account No. 18 were made in the following manner: The management company, as taxpayer's agent, instructed its brokers, members of the New York Stock Exchange, to sell a certain number of Drug, Inc. shares. When the broker confirmed the sale, the management company instructed Bankers Trust Company, the custodian, to deliver to the broker the number of shares sold and to receive the sale price from the broker for the benefit of Short Account No. 18. Purchases were made in a like manner; the management company instructed its brokers to buy a certain number of Drug, Inc. shares and, upon confirmation of the purchase, directed the Bankers Trust Company, as custodian, to receive the purchased shares and to pay the purchase price to the broker from the custodian account. All of the purchases made for Short Account No. 18 were matched against the earliest sales in that account not theretofore matched, for the purpose of reflecting the gain or loss on such sales. (R. 54.)

In Short Account No. 18 each sale was reflected by entries of the date, the name of the broker making the sale, the number of shares sold, the "short balance" in shares as increased by the sale on that date, the sale "price" per share, the "proceeds of sale", and the net "short balance" in dollars and cents as increased by the proceeds of the sale on that date. Each purchase was reflected in that account by entries

of the date, the name of the broker making the purchase, the number of shares bought, the "short balance" in shares as decreased by the purchase on that date, the purchase "price" per share, the total "cost debit", the "profit or loss" represented by the difference between the selling price and the purchase price of the matched sale and purchase, the "cost credit" represented by the cost plus the profit or minus the loss, and the net "short balance" in dollars and cents as decreased by such cost credit on that date. (R. 26 and eight photostat sheets, R. 54–55.)

For the year 1932 taxpayer computed, as a profit realized through Short Account No. 18, the amount of $377,043, representing the excess of the proceeds of sales over the cost of all matched purchases made during 1932. He reported this amount, with adjustments not here pertinent, as income for 1932. For the year 1933, taxpayer computed, as a loss sustained through Short Account No. 18, the amount of $158,076.50, representing the excess of the cost of matched purchases made during 1933 over the proceeds of prior sales. He claimed a deduction for this amount, with adjustments not here pertinent, for 1933. (R. 56.)

In his deficiency notice for the year 1933 the Commissioner stated that the amount of $377,043, reported in taxpayer's 1932 return as a profit from Short Account No. 18 had been eliminated for that year because the transactions had not then been completed by a return of the borrowed shares to the lenders. He determined that, with certain exceptions,[2] the transactions embraced in Short Account No. 18 during the period from February 25, 1932, to July 17, 1933, were transactions with borrowed shares and that such transactions were not completed and closed until the taxpayer returned the 27,700 borrowed shares to the lenders in June and July, 1933. (R. 56.) Ac-

[2] The exceptions relate to certain sales which were treated by the Commissioner as ordinary sales, not short sales, because the taxpayer had no borrowed stock to deliver against those sales. The taxpayer has now abandoned this issue (Pet. 16, 19).

cordingly, he disallowed the claimed loss of $158,076.50 for 1933 and instead included in taxpayer's income for that year the profit of $98,214 which taxpayer had realized on all of the transactions in Short Account No. 18 for the years 1932 and 1933, with the exceptions noted in note 2, *supra*. The Board of Tax Appeals sustained the action of the Commissioner (R. 57–59) and the court below affirmed (R. 149).

ARGUMENT

1. *The trust income issue.*—The Commissioner, the Board of Tax Appeals and the court below determined that the taxpayer's unfettered control over the trust property was the equivalent of ownership for tax purposes and that the trust income was therefore taxable to the taxpayer under Section 22 (a) of the Revenue Act of 1932. This conclusion was plainly compelled by the controlling decision of this Court in *Helvering* v. *Clifford*, 309 U. S. 331. The taxpayer here not only had the same sweeping powers of management over the trust property as the taxpayer had in the *Clifford* case, but he also had the right to use the property for his own benefit in the various ways pointed out in the Statement, and the right to take the property himself—not after five years, as in the *Clifford* case, but at any time he saw fit. If the taxpayer in the *Clifford* case is to be regarded for tax purposes as the owner of the trust property, as this Court held, it follows *a fortiori* that the taxpayer here must be so regarded.

Petitioner seeks to distinguish the two situations on the ground that the taxpayer here was not, as in the *Clifford* case, the grantor of the trust but was simply the recipient of powers vested in him by the action of his wife. The distinction is without substance. The crucial issue is whether the taxpayer's dominion and control over the trust property is so nearly akin to ownership that, for tax purposes, he must be treated as the owner. In determining that issue, the source of the taxpayer's dominion and control—i. e., whether it derives from powers reserved by him in a trust which he him-

self creates or from powers conferred upon him in a trust which someone else creates—is plainly irrelevant. Whatever the source of the taxpayer's "bundle of rights", if they are such as to vest in him substantially all of the attributes of ownership, he must be treated for purposes of taxation as owner altogether.

There is no conflict with *Helvering* v. *Safe Deposit & Trust Co.*, 121 F. (2d) 307 (C. C. A. 4), now pending on writ of certiorari, No. 600, present term. The question in that case is whether a decedent who had a life interest in trust property and a general testamentary power of disposition of the property had an "interest" in the property within the meaning of Section 302 (a) of the Revenue Act of 1926. The Fourth Circuit answered that question in the negative, not on the ground that decedent's rights in and to the trust property were substantially less than those of a fee owner, but on the ground that the term "interest" refers to a technical common-law estate in property and that decedent had no such estate. In this view of the meaning of the estate tax law, of course, the rule of the *Clifford* case was considered inapplicable.

2. *The short sale issue.*—The decision of the court below that gain or loss with respect to the short sales made in Short Account No. 18 was not realized until 1933 when the borrowed stock was returned to the lenders involves no conflict and, since the issue turns largely on facts peculiar to this case,[3]

[3] The sales made by the taxpayer were not the ordinary type of short sales where a taxpayer's broker borrows the stock for him or where the broker himself lends the taxpayer the stock. See *Henry B. Du Pont* v. *Commissioner*, 98 F. (2d) 459 (C. C. A. 3), certiorari denied, 305 U. S. 631; *Henry F. Du Pont* v. *Commissioner*, 110 F. (2d) 641 (C. C. A. 3), certiorari denied, 311 U. S. 657; *Helvering* v. *Wilmington Trust Co.* (C. C. A. 3), decided September 3, 1941, not yet officially reported but may be found in 1941 C. C. H., Vol. 4, Par. 9666. In such a case the broker's records clearly show when the short sales are executed, how many shares the taxpayer is short, and when the short sales are covered. In this case, the taxpayer himself borrowed the stock from a corporation and then delivered the stock through the Bankers Trust Company to his broker. When the broker purchased stock for the taxpayer, the Bankers Trust Company took delivery of the shares and paid the broker the purchase price (R. 54, 118, 121). The tax-

it presents no question of general importance warranting review by this Court.

The taxpayer relies largely on the decisions in *Commissioner* v. *Dashiell*, 100 F. (2d) 625 (C. C. A. 7); *Commissioner* v. *Ferree*, 84 F. (2d) 124 (C. C. A. 3); *Huntington Nat. Bank* v. *Commissioner*, 90 F. (2d) 876 (C. C. A. 6); *Commissioner* v. *Robinson*, 103 F. (2d) 1009 (C. C. A. 6); *Commissioner* v. *Mott*, 103 F. (2d) 1009 (C. C. A. 6); and *Ruml* v. *Commissioner*, 83 F. (2d) 257 (C. C. A. 2). In these cases, the taxpayer, near the end of the year, instructed his broker to sell stock which he owned but which he was unable actually to deliver to the broker until the following year; the question was whether the sales were made in the earlier or later year for purposes of determining gain or loss. The holding in each case was that the sales took place in the earlier year because in that year the taxpayer definitely identified the stock to be delivered to the purchaser. In none of the cases was there any intention on the part of the taxpayer to execute a short sale or to cover a short sale.

In this case, on the other hand, there were admittedly sales of borrowed stock and the basis of such stock for the purpose of determining gain or loss could not be known until other shares of stock were definitely identified as dedicated to covering the short sales. The theory of the decision below was that the matching of the purchased stock against the short sales on the books of Short Account No. 18 did not serve as such a definite identification because, until the Short Account was closed out by a return of the stock to the lenders, the taxpayer could use the purchased shares for any purpose he wished, notwithstanding the book entries. The Court thus concluded that there was no irrevocable dedication of any particular shares to the

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payer's agent testified that the broker did not know whether the transaction was a long sale or a short sale (R. 123). Therefore the broker's records would not show the taxpayer's long and short position; the sales and purchases were cash transactions and there was actual delivery or receipt of the stock in each instance.

covering of the short sales—and therefore no basis for determining gain or loss—until the borrowed shares were returned to the lenders.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER, 1941.

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FILED
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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM—1941

H. S. RICHARDSON,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 692

PETITION FOR RECONSIDERATION OF PETITION FOR WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

OCTOBER TERM—1941

H. S. RICHARDSON, Petitioner, against COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 692

PETITION FOR RECONSIDERATION OF PETITION FOR WRIT OF CERTIORARI.

To the Honorable Justices of the United States Supreme Court:

Petitioner prays for reconsideration of the Petition for a Writ of Certiorari herein, denied November 10, 1941, in so far as said Petition related to the issue therein described as the Trust Issue, and respectfully shows:

The Circuit Court of Appeals based its decision in this case entirely on *Helvering* v. *Clifford*, 309 U. S. 331 (1940). The petitioner in the Circuit Court of Appeals and in its Petition for a Writ of Certiorari contended that the *Clifford* case was inapplicable because the petitioner was not the grantor of the trusts in issue, and that the distinction for tax purposes between powers *reserved* by an owner of property in a grant thereof and powers *donated* by the owner to a third person was fundamental. The sole question in this case is whether in spite of these contentions the *Clifford* case is applicable.

Since the denial by this Court of the Petition for a Writ of Certiorari, Petitions for Writs of Certiorari have been filed in two cases involving the application of the *Clifford* case.

Woolley v. *Commissioner*, 122 F. (2d) 167 (C. C. A. 2, 1941) in which a Petition for a Writ of Certiorari was filed on November 14, 1941, Docket No. 743.

Elias v. *Helvering*, 122 F. (2d) 171 (C. C. A. 2, 1941) in which a Petition for a Writ of Certiorari was filed on November 11, 1941, Docket No. 728.

There is also pending before this Court a Petition for a Writ of Certiorari in the case of *Barbour* v. *Commissioner*, 122 F. (2d) 165 (C. C. A. 2, 1941), filed on November 4, 1941, Docket No. 727.

Each of the above cases has as its primary issue the applicability of the *Clifford* case. If this Court should grant the Petitions in any of the above cases in order to settle some of the many questions raised by the *Clifford* case, it is submitted that the Petition for the Writ of Certiorari should be granted herein, since the phase of the *Clifford* case doctrine presented by this case is one which is constantly recurring. This is shown by the fact that in the short time since the filing of the Petition for a Writ of Certiorari herein three cases have been decided by the Board of Tax Appeals involving the applicability of the *Clifford* doctrine in cases such as this where the taxpayer was not the grantor of the trusts involved. *William W. Bolton*, 45 B. T. A.—No. 56; *Archer L. Bolton*, 45 B. T. A.—No. 57; *Ella E. Russell*, 45 B. T. A. —No. 71. The difficulty of the question is shown by the fact that in the two *Bolton* cases the decisions were in favor of the taxpayers, while in the *Russell* case the decision was in favor of the Commissioner by a divided Board. The division was on the question as to the applicability of the decisions of the Circuit Court of Appeals and the Board herein to the facts in the *Russell* case.

Petitioner also points out that on October 27, 1941 this Court granted the Petition for a Writ of Certiorari in *Helvering* v. *Safe Deposit & Trust Company of Baltimore*, 121 F. (2d) 307 (C. C. A. 4, 1941), Docket No. 600, which it is submitted, represents a conflict in principle with the decision of the Circuit Court of Appeals herein.[1]

[1] Petition, pages 12-14.

If the Petition for a Writ of Certiorari is granted herein, it is suggested that the case be set down for argument with any of the related cases discussed above which may then be pending before this Court.

Petitioner renews the arguments advanced in its Petition for a Writ of Certiorari, but does not repeat them here.

This Petition for Reconsideration is limited to the issue described in the Petition as the Trust Issue and does not apply to the issue described therein as the Short Sale Issue.

Therefore it is prayed that the Court reconsider the Petition for Certiorari and grant the same.

Respectfully submitted,

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HOLT S. MCKINNEY,
JOSIAH WILLARD,
of Counsel.

We certify that this Petition is presented in good faith and not for delay.

Counsel for Petitioner.